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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 791

IRENEE DU PONT, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 14–15) is reported in 20 B.T.A. 482. The opinion of the Circuit Court of Appeals (R. 21–27) is reported in 63 F. (2d) 44.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 6, 1933 (R. 27). The petition for a writ of certiorari was filed March 20, 1933,

and was granted March 27, 1933 (R. 28). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether Section 219 (h) of the Revenue Acts of 1924 and 1926 may be constitutionally applied to the income of the trusts involved in this case.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 17–19.

STATEMENT

The facts found by the Board of Tax Appeals (R. 12–14) may be summarized as follows:

On September 18, 1923, the petitioner created nine trusts for the benefit of his wife and children under the terms of which he transferred to the trustee 830 shares of 7 per cent preferred stock of the Christiana Securities Company, a Delaware corporation, and thirty-two insurance policies on his life. The trusts were irrevocable for their duration of three years with provisions for further extension upon notice by the settlor to the trustee. Two such notices were given and the trusts were extended at least to December 18, 1932. They were in force and effect during the taxable years involved; the policies were then in effect, and all of the beneficiaries of the trusts were living (R. 12, 14).

By the trust instruments the trustee was made the owner of the insurance policies and it was provided that if the trusts terminated prior to the petitioner's death, all interest in the policies would vest in certain named beneficiaries. The petitioner is not one of such beneficiaries and he retains no right to change the beneficiaries. He has no right to surrender the policies for their cash-surrender value or to borrow money on them. There is no provision under which title to the policies could revest in him either at his own discretion or that of him jointly with anybody else (R. 12–13).

If the petitioner should die prior to the termination of the trusts, the proceeds of the life-insurance policies are to become a trust fund in the hands of the trustee, designated as the Primary Trust Fund. The net income from this fund and the fund itself would be distributed to the beneficiaries named in the trust agreements and not to the petitioner or his estate (R. 13).

As to the shares of stock transferred under the trust agreements, the trustee receives the dividends thereon and applies this income after deducting taxes, governmental charges, and incidental expenses, including its commissions, to the payment of the premiums on the policies of life insurance for the period of the trusts, or so long as the petitioner lives, whichever is shorter (R. 13).

If the trusts terminate prior to the petitioner's death, these securities and any income not paid out,

all of which is designated the Secondary Trust Fund, are to be transferred to the petitioner. If the petitioner dies prior to the end of the trusts, this fund is to be distributed to the nine children or their issue in the manner specified and no part thereof is to be distributed to the petitioner's estate (R. 13).

During the year 1924, dividends from securities transferred to and held by the trustee (Wilmington Trust Company), amounting to $50,422.40, were received by the trustee and, pursuant to the terms of the trusts, were used to pay insurance premiums. During the years 1925 and 1926 dividends in the amounts of $50,370.10 and $50,422.40, respectively, were received from securities held by the trustee. These dividends also were used to pay premiums on the life-insurance policies (R. 13–14).

The Commissioner of Internal Revenue asserted deficiencies against the petitioner for 1924, 1925, and 1926 as the result of including the dividends thus applied in the petitioner's gross income for those years. The Board of Tax Appeals sustained the Commissioner's determination and upon appeal the Circuit Court of Appeals affirmed the Board's decision.

SUMMARY OF ARGUMENT

I

Section 219 (h) of the Revenue Acts of 1924 and 1926 is constitutional when applied to irrevocable trusts. The argument on this question is the same

as that presented at pp. 9–21 of the Government's brief in *Commissioner* v. *Wells,* No. 792, October Term, 1932, and need not be repeated here.

II

Section 219 (h) of the Revenue Acts of 1924 and 1926, when applied to the income of property held under a trust indenture which reserves the right to retake the property after three years unless the settlor dies before that time, does not offend the Constitution. Because of his right to retake the property after three years, the settlor retains a substantial interest in the trust fund which affords sufficient constitutional basis for the tax upon the income derived therefrom. In effect the trusts in this case were nothing more than a setting aside of future income without a complete and unqualified transfer of the property producing that income. The petitioner merely "postponed his command" over the trust property. The transfer was incomplete and for estate-tax purposes the trust property could have been included in the settlor's estate if he had died within the period of the trusts. If Congress could impose death duties upon the transfer of the settlor's interest in the trust property upon his death, it could tax the income to him during his life.

We believe therefore that Congress did not exceed its power in providing that the tax on the income of property must be paid by the grantor of the property who retains to himself so great an

interest in it. And this is especially true where the income is applied pursuant to the direction of the grantor and for his purposes.

III

Even though it be held that Section 219 (h) may not constitutionally be applied to all the income in question in this case, the tax asserted for the year 1926 may nevertheless be sustained under Section 219 (g) of the Revenue Act of 1926 (*infra*, p. 19). Income for that year is plainly within the terms of Section 219 (g). The limitation on the settlor's control of the trust property was only temporary, and wholly expired within the taxable year.

ARGUMENT

Section 219 (h) of the Revenue Act of 1924 (*infra*, p. 19), provided that—

> where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor * * * such part of the income of the trust shall be included in computing the net income of the grantor.

Section 219 (h) of the Revenue Act of 1926 was the same.

The petitioner raises no question regarding the interpretation of this provision. He does not argue that Section 219 (h) is not applicable to irrevocable trusts or that it is not applicable to such trusts created before June 2, 1924, when this pro-

vision was first enacted. On the contrary, the petitioner's sole argument is that Section 219 (h) is unconstitutional.[1]

I

SECTION 219 (h) OF THE REVENUE ACTS OF 1924 AND 1926 IS CONSTITUTIONAL WHEN APPLIED TO IRREVOCABLE TRUSTS

In the Government's brief in *Commissioner* v. *Wells,* No. 792, October Term, 1932, it is contended that Section 219 (h) of the Revenue Acts of 1924 and 1926 is constitutional when applied to the income of insurance trusts which are irrevocable and under the terms of which the settlor has forever parted with title to the fund. For the reasons there advanced, which need not be repeated here, we contend that Section 219 (h) is constitutional when applied to the trusts involved in this case.

If the Government prevails in the *Wells case,* the decision there will be conclusive here. If the tax involved in the *Wells case* is not sustained, we submit that the statute must nevertheless be upheld in its application to the trusts here involved under which substantial property interests were reserved to the settlor. Cf. *Dahnke-Walker Co.* v. *Bondurant,* 257 U.S. 282, 289. Our reasons for this contention, which need not be considered unless the

[1] In the Government's brief in *Commissioner* v. *Wells,* No. 792, October Term, 1932, it is argued (p. 8) that Section 219(h) is applicable to irrevocable trusts and (pp. 22–23) that it is applicable to trusts created before June 2, 1924.

taxpayer prevails in the *Wells case,* are presented below.

II

SECTION 219 (h) OF THE REVENUE ACTS OF 1924 AND 1926 MAY BE CONSTITUTIONALLY APPLIED TO THE INCOME OF PROPERTY HELD IN TRUST WHERE THE GRANTOR OF THE TRUST RESERVES THE RIGHT TO RETAKE THE PROPERTY AFTER THREE YEARS UNLESS HE DIES BEFORE THAT TIME

The trusts involved in this case were created September 18, 1923. They were not final, complete, and unqualified dispositions of property leaving no interest in the grantor, for, although they were "irrevocable for their duration", they continued only until December 18, 1926 (R. 12). If the grantor was living at that time,[2] he had the option to extend the trusts for a further period of three years but it was provided that if he did not choose to extend the period "the securities and any income not paid out * * * are to be transferred to the petitioner" (R. 13). In other words, the petitioner created trusts which were to last for three years, during which time part of the income was to be used for the purpose of paying premiums on insurance on his own life. At the end of any tri-

[2] The chance of the petitioner's dying within the three-year period was very small, so that the transfers were for practical purposes the same as if they had been for three years without qualification. If we assume that the petitioner was 47 years old when the trusts were created (it is stated in Who's Who that Irenee du Pont was born December 21, 1876), the probability that he would survive for three more years according to the American Men Table of Mortality was 0.9710625, or over 97%.

ennium, the trusts were to terminate unless extended by the settlor, and the principal of the trust fund, together with any unexpended income, revested absolutely in the grantor. Thus the settlor retained a substantial interest in the trust property quite apart from the benefit which he derived in having the income applied to pay the premiums on insurance on his own life. In substance and effect it was as if he had established a trust for his life, reserving power to revoke it upon the expiration of each triennium after its creation.

The petitioner seems therefore to be in error in stating in his brief (p. 7) that "The petitioner was in no sense a beneficiary of the trusts", and (p. 9) that the petitioner "had no interest in the corpus" of the trusts. Similarly the statement on p. 12 of the petitioner's brief that "the income was not derived from a corpus in which the petitioner had any rights during the taxable years" and the inference on p. 18 that the transfers were an "absolute gift" seem unfounded. The petitioner retained at all times an interest in the property which was very substantial in extent, an interest which was transferable during the years in question, and which could have been protected in equity if the trustee had failed in any way to recognize it. This interest in the property continued throughout the taxable years here involved. We submit that the petitioner was not deprived of his property without due process of law in being required to pay a tax on the income derived from property in which

he retained so great an interest. It was not an arbitrary, capricious, or unreasonable exercise of legislative power to require the payment of such a tax when the income was applied pursuant to the directions of the settlor and for his purposes.

The trusts in this case were in effect nothing but a setting aside of future income without a complete and unqualified transfer of the property producing that income. It has frequently been held that such a transfer of future income from property is not effective to prevent the income of the property from being taxed to the owner of the property. *Parker* v. *Routzahn*, 56 F. (2d) 730 (C.C.A. 6th), certiorari denied, 287 U.S. 606; *Rosenwald* v. *Commissioner*, 33 F. (2d) 423 (C.C.A. 7th), certiorari denied, 280 U.S. 599; *Dickey* v. *Burnet*, 56 F. (2d) 917, 920 (C.C.A. 8th), certiorari denied, 287 U.S. 606; *Van Meter* v. *Commissioner*, 61 F. (2d) 817, 818–819 (C.C.A. 8th); *Ward* v. *Commissioner*, 58 F. (2d) 757 (C.C.A. 9th); *Leydig* v. *Commissioner*, 43 F. (2d) 494, 496 (C.C.A. 10th); *Porter* v. *United States*, 52 F. (2d) 1056, 1057 (C.Cls.). As the court below said (R. 25), the petitioner merely "postponed his command" over the trust property.

If the owner of property may put its income beyond the constitutional power of Congress to tax it to him by providing through a trust that the income shall be paid for a period of three years to another and that the property shall then revert to him, he would be equally immune from taxation

if he established a trust renewable from year to year or month to month, and the provisions of Section 219 (g) as well as Section 219 (h) would be unconstitutional in their application to the income from such trusts. Plainly, such trusts amount to nothing more than anticipatory dispositions of the future income of property in which the grantor retains substantial ownership. To hold that Congress may not constitutionally tax such income to the person who creates the trust and who retains so great an interest in the trust property would obviously facilitate evasion. Cf. *Lucas* v. *Earl*, 281 U.S. 111.

That the relation which the petitioner retained to the trust property was close enough to support the tax in question is shown by decisions of this Court under the estate tax statutes. In *Reinecke* v. *Smith*, No. 601, October Term, 1932, decided April 10, 1933, this Court said that—

> the same considerations as to ownership and control affect the power to impose a tax on the transfer of the corpus and upon the income.

Under the rule thus announced, considerations as to ownership and control of the trust property sufficient to sustain the power of Congress to require inclusion of the property in the petitioner's estate for estate tax purposes must be accepted as sufficient to sustain the constitutionality of a Federal tax upon the income from the fund.

We cannot doubt the power of Congress to tax the trust fund as part of the settlor's estate in case of his death during the life of the trusts. The trust property was transferred to the trustee for a period of three years only. If the petitioner died within three years, the property was to be distributed by the trustee to named persons. If he survived the three-year period, the property became his absolutely. The transfer was thus plainly within Section 302 (c) of the Revenue Act of 1924 as applied by this Court in *Klein* v. *United States*, 283 U.S. 231. There, a husband transferred property to his wife for life with the provision that if he died before she did the property should be hers absolutely. Here, the property was transferred upon trusts for three years with the provision that if the grantor died within that period the transfers should be absolute. As in the *Klein case* (p. 234), "the death of the grantor was the indispensable and intended event" which was necessary to make effective the ultimate transfer of the trust property to the beneficiaries. The transfer would also be taxable under the rule applied to revocable trusts in *Reinecke* v. *Northern Trust Co.*, 278 U.S. 339. The only difference between the cases is that there the power to revoke was continuous while here it was periodically recurring—a difference in control which, we believe, is not sufficient to require different results. See also *Tyler* v. *United*

States, 281 U.S. 497; *Third National Bank* v. *White,* 287 U.S. 577.

The transfers here were plainly testamentary in form and in substance. For the reasons stated above, in addition to the reasons presented on the similar question at p. 12 of the brief for the Government in *Commissioner* v. *Wells,* No. 792, October Term, 1932, we believe that the trust property would have been taxable as a part of the grantor's estate if he had died while the trusts were in effect.

In view of the fact that the trusts in this case amounted to nothing more than anticipatory arrangements disposing of the future income of property, without any similar disposition of the property itself, and that the transfers would have been taxable as a part of the grantor's estate had he died within the period, we believe it is plain that Congress did not exceed its power in providing that the income from the property should be taxed to the grantor.

For the most part, the petitioner ignores in his brief the effect of the substantial interest which he retained in the trust property. Two cases (*Nail* v. *Commissioner,* 27 B.T.A. 33; *United States* v. *Looney,* 29 F. (2d) 884 (C.C.A. 5th)) are, however, cited in support of the proposition that "income should be taxed to the holder of the present estate rather than to the holder of the future estate" (Br. 17–18). But these cases are plainly inap-

plicable here. They relate solely to the *construction* of the provisions of the statute relating to the taxation of income in ordinary cases (Sections 210 and 211), where, as this Court has held, "ownership" of the income is the principal test. *Poe* v. *Seaborn*, 282 U.S. 101, 109. But no question of construction is involved here. The sole issue raised is that of the *constitutionality* of Section 219(h), which admittedly provides that the income shall be taxed as the Commissioner has taxed it. In view of all the circumstances it seems plain that Congress is not prevented by the Constitution from taxing the income to the petitioner whether he "owned" the income or not.[3]

III

THE PETITIONER IS TAXABLE ON THE INCOME OF THE TRUSTS FOR THE YEAR 1926 UNDER SECTION 219 (g) OF THE REVENUE ACT OF 1926

Even if it be held that Section 219 (h) may not constitutionally be applied to the income in question in this case, the tax asserted by the Com-

[3] The petitioner's confusion of the issues of *construction* and *constitutionality* seems also apparent in the reliance placed on Section 501 of the Revenue Act of 1932 (Br. 19–20). We believe it is obvious that no provision of the Revenue Act of 1932 can affect the *constitutionality* of a statute passed in 1924. Moreover, the petitioner's illustrations fail to show any "capriciousness" even under the Revenue Act of 1932. A tax on the creation of an irrevocable trust and on the income from it are distinct, and Congress may impose both if it chooses. Cf. *Lang* v. *Commissioner*, No. 595, October Term, 1932, decided April 10, 1933.

missioner for the year 1926 may nevertheless be sustained under Section 219 (g) of the Revenue Act of 1926 (*infra,* p. 19). This section provides that—

> Where the grantor of a trust has, at any time during the taxable year, * * * the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

It was within the power of the petitioner to revest in himself title to the entire corpus of the trust property during the year 1926. The trusts by their terms were to last only until December 18, 1926, and the petitioner then had the option to extend them for a further three-year period. Unless he exercised this option the securities and any accumulated income became the petitioner's property free of the trusts (R. 13).

The situation is, therefore, plainly within the terms of Section 219 (g), and we do not believe that there can be serious question of the constitutionality of this provision as applied to the income for 1926. The validity of Section 219 (g) has been upheld in *Corliss* v. *Bowers,* 281 U.S. 376, and in *Reinecke* v. *Smith,* No. 601, October Term, 1932, decided April 10, 1933. The only distinction between those cases and this is that the settlor's power (subject in the *Smith case* to the consent of another) was continuous throughout the

taxable year while here the power was effective only at one period of time within the taxable year. We do not believe that this distinction is significant. The limitation on the settlor's control over the trust property was only temporary, and wholly expired within the taxable year. We believe that it cannot be said that Congress has no power under the Constitution to tax the income of property to a person who has power within the year to take the property for himself.

CONCLUSION

The decision of the Circuit Court of Appeals is correct and should be affirmed.

Respectfully submitted.

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MAY 1933.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1924, c. 234, 43 Stat. 253, 264, 265, 275:

> SEC. 210. (*a*) In lieu of the tax imposed by section 210 of the Revenue Act of 1921, there shall be levied, collected, and paid for each taxable year upon the net income of every individual (except as provided in subdivision (b) of this section) a normal tax * * *. (U.S.C., Title 26, Sec. 951.)
>
> SEC. 211. (*a*) In lieu of the tax imposed by section 211 of the Revenue Act of 1921, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows: * * * (U.S.C., Title 26, Sec. 952.)
>
> SEC. 219. (*a*) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—
>
> (1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;
>
> (2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * *

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year

which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

* * * * *

(g) Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

(h) Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him, or where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in paragraph (10) of the subdivision (a) of section 214), such part of the income of the trust shall be included in computing the net income of the grantor. (U.S.C., Title 26, Sec. 960).

Section 219 of the Revenue Act of 1926 (U.S.C. App., Title 26, Sec. 960) is identical with Section 219 of the Revenue Act of 1924, quoted above.

Extracts from the pertinent Treasury Regulations and from the reports of Congressional Committees are set forth at pp. 35–39 of the Government's brief in *Commissioner* v. *Wells,* No. 792, October Term, 1932.

U. S. GOVERNMENT PRINTING OFFICE : 1933